

BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Commission, on its)	Application No. NUSF-50
Own Motion, to Make Adjustments to the)	
Universal Service Fund Mechanism)	Progression Order No. 1
Established in NUSF-26.)	

**Reply Comments of
The Rural Independent Companies**

I. Introduction

The Rural Independent Companies (the “Companies”) submit reply comments in the above-referenced docket. The Companies appreciate the opportunity to respond to comments in this matter, which was opened by Progression Order No. 1 (the “Order”) of the Nebraska Public Service Commission (the “Commission”) entered in this proceeding. The Commission opened this docket to consider certain adjustments to the permanent universal service fund mechanism established in the NUSF-26 docket. In the Order, the Commission seeks comments on various issues relating to whether the Nebraska Universal Service Fund (“NUSF”) mechanism should be modified in light of the Commission’s previous decision to reduce the NUSF surcharge from 6.95 percent to 5.75 percent of intrastate retail revenues on telecommunications services.¹ The Companies appreciate the opportunity to participate in this important proceeding.

As a threshold matter, the Companies agree with Citizens Telecommunications Company of Nebraska d/b/a Frontier Communications of Nebraska (“Frontier”) that it is difficult to respond to alternative courses of action when long run projections of the collections and distribution requirements have not been made a matter of public record.²

¹ See *Order* at ¶ 2.

² See *The Commission, on its Own Motion, to Make Adjustments to the Universal Service Fund Mechanism Established in NUSF-26*, Application No. NUSF-50, P.O. No. 1, Comments of Citizens

Further, the possible adjustments that the Commission is contemplating are interdependent relative to the outcomes that are produced in the actual distributions.³ Without a specific plan, analysis of the change combinations is unmanageable. The Companies reassert their contention that the Commission should conduct another proceeding that outlines proposed changes to the support mechanism with the concomitant impact projections for each fund recipient. As a part of that proceeding, the results of such projections will need to be analyzed for their impacts on attaining the NUSF statutory goals of sufficiency and predictability for all qualifying carriers.

II. The Transitional Mechanisms Should Be Modified As An Initial Remedy If The Commission Wishes To Reduce The Total Amount Of NUSF Support Distributed

As stated in our initial comments, the Companies do not believe it is appropriate to reduce the amount of NUSF support distributed. However in the event that the Commission chooses this course, it should accomplish this reduction through a gradual reduction in the amount of support for which carriers may be eligible through the per-line backstop and the overearnings redistribution (“OER”) transitional mechanisms.⁴ The Commission has found that the permanent universal service support mechanism in NUSF-26 “highly targets support to the most costly and sparsely populated out-of-town service areas where NUSF support is needed.”⁵ Frontier argues that “before any other

Telecommunications Company of Nebraska d/b/a Frontier Communications of Nebraska (“*Frontier Comments*”) (filed March 24, 2006) at p. 2.

³ Ibid.

⁴ See *The Commission, on its Own Motion, to Make Adjustments to the Universal Service Fund Mechanism Established in NUSF-26*, Application No. NUSF-50, P.O. No. 1, Comments of The Rural Independent Companies (“*Companies’ Comments*”) (filed April 14, 2006) at p. 9.

⁵ See *The Nebraska Public Service Commission, on its own motion, seeking to establish a long-term universal service funding mechanism*, Application No. NUSF-26, Findings and Conclusions (“*NUSF-26 Permanent Methodology Order*”) (entered Nov. 3, 2004) at ¶ 11.

modifications to the support mechanisms are implemented, the Commission should first shorten the transitional support mechanism to more rapidly bring companies to a level of need determined on the NUSF-26 mechanism.”⁶ The transitional mechanisms provide support over and above the level of need determined by the NUSF-26 mechanism, and thus the transitional funding should be the priority consideration for reduction when and if the Commission is confronted with a shortage of funds.⁷ Frontier questions why the transition period should take longer than two or three years.⁸ The Companies share Frontier’s concerns and in the event the Commission determines a need to reduce the amount of support distributed, recommend either eliminating the transition mechanisms (as suggested by Frontier) or reducing the amount paid through these mechanisms beginning in the 2007 calendar year.

Qwest Corporation (“Qwest”), on the other hand, makes the self-serving argument that “OER be extended indefinitely.”⁹ Qwest makes the argument that if the transition mechanisms were immediately terminated, Qwest would end up with less than \$4,000,000 in NUSF support after more than \$10,000,000 is ported to CLECs.¹⁰ The Companies submit that if Qwest believes that the manner in which NUSF support is ported is inappropriate, it should raise those concerns in proceedings that are currently

⁶ See *Frontier Comments* at p. 2.

⁷ *Id.* at p. 3.

⁸ *Ibid.*

⁹ See *The Commission, on its Own Motion, to Make Adjustments to the Universal Service Fund Mechanism Established in NUSF-26*, Application No. NUSF-50, P.O. No. 1, Qwest Corporation’s Initial Comments to Progression Order No. 1 (“*Qwest Comments*”) (filed April 14, 2006) at p. 6.

¹⁰ *Ibid.*

open which address the porting issue, instead of attempting to raise those concerns in the instant proceeding.¹¹

Qwest's proposal to make permanent the transition mechanisms is inconsistent with the intent of these mechanisms that were designed to provide companies with a transitional glide-path to permanent support levels, but by no means provide a permanent "crutch." Such a result would make the basic Support Allocation Mechanism dysfunctional and is the antithesis of a reasonable means to deal with any shortage of funds.

III. The Commission Should Maintain the Current 12 Percent Cap On Rate-of-Return.

The Companies believe that the record of comments in this proceeding provides no basis for a conclusion that it would be appropriate to reduce the allowed rate-of-return ("ROR") currently in place under the NUSF. ROR has historically been determined by identifying a particular company's weighted average cost of capital. The federal ROR for incumbent local exchange carriers ("ILECs") has recently been examined in two proceedings and was ordered to be maintained at 11.25 percent.¹² The weighted average

¹¹ See *The Commission, on its Own Motion, to Make Adjustments to the Universal Service Fund Mechanism Established in NUSF-26*, Application No. NUSF-50, Progression Order No. 2 (entered Feb. 28, 2006) and *The Commission, on its Own Motion, Seeking to Investigate Whether the Zones Established in Docket No. C-2516 are Appropriate in Light of NUSF-26 Findings and Conclusions*, Application No. C-3554/PI-112, Order Opening Docket (entered Feb. 28, 2006).

¹² See *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-66, *Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166 Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, FCC 01-304 ("MAG Order") (rel. Nov. 8, 2001) at ¶¶ 206-210 and *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, and *Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket No. 97-160, Tenth Report and Order, FCC 99-304 (rel. Nov. 2, 1999) at ¶ 435.

cost of capital is not likely to be greatly differentiated between the state and federal jurisdictions. The Companies pointed out in their initial comments that the ROR cap used for NUSF purposes should be higher than the weighted average cost of capital because NUSF ROR cap is used to set the maximum amount of earning allowed and does not represent a guarantee of return.¹³ The Commission should consider the recent Federal Communications Commission (“FCC”) determination on cost of capital as a basis for maintaining the current NUSF ROR cap at 12 percent and should not impose a new arbitrary cap.

Frontier makes the point that lowering of the ROR cap also may serve to punish carriers that are most efficient. Carriers that have reduced their expenses through efficiency measures would likely increase their earnings. The Commission should not reduce the NUSF support to an efficient provider while rewarding a potentially inefficient provider with no reduction in NUSF funding.¹⁴ Meanwhile, Qwest argues without substantiation that a reduction in the ROR cap “will ensure that support is distributed to carriers that need it the most.”¹⁵ To the contrary, this misguided and unsupported notion could very well reward a carrier that is inefficient or that has experienced competitive losses.

Qwest further argues that the Commission should require that carriers seeking higher rates of return should become more efficient and obtain more revenues from sources other than universal service funds.¹⁶ Qwest fails to recognize that unless a carrier

¹³ See *Companies’ Comments* at p. 16.

¹⁴ See *Frontier Comments* at p. 5.

¹⁵ See *Qwest Comments* at p. 2.

¹⁶ *Ibid.*

reports its earnings on a supported services basis (on the NUSF-EARN form), an increase in efficiency or generation of revenue from non-universal service sources will actually serve to increase its ROR. If the increase in ROR causes a carrier to exceed the ROR cap, the increased revenues from other sources will be offset by decreased NUSF support and therefore will not produce the effect that Qwest is suggesting. In addition, it is obvious that in the most-rural areas of Nebraska, such as those served by many of the Companies, where population growth is stagnant or negative, such revenue growth opportunities are unlikely to exist.

Qwest's comments also insinuate without basis that carriers that are over-earning are failing to invest in their networks.¹⁷ In reality, there is not necessarily an actual cause and effect relationship between current investment activity and the reporting of earnings on the NUSF-EARN form. As Frontier indicates, because the earnings test is based on historical investment and current depreciation, a company's earnings may be below the 8 or 10 percent earnings threshold, even though the company has made little or no current or recent investment. Conversely, a company that has made sizable new investments in Nebraska may exceed the earnings cap threshold because of extended depreciation lives for the investment and thereby remain disqualified from NUSF support.¹⁸ Qwest's comments should be recognized for what they appear to be – an attempt to reduce the ROR cap, a step that could negatively affect companies that invest in infrastructure in Nebraska, and in the process shift even more support into transitional mechanisms benefiting Qwest and away from the areas of the state that require such support in order

¹⁷ See *Qwest Comments* at p. 7.

¹⁸ See *Frontier Comments* at p. 5.

to ensure continued investment. This result is contrary to already-adjudicated NUSF-26 goals and state law.

IV. The Commission Should Allow Carriers to Increase Their Access Rates If NUSF Support Amounts Are Reduced.

The NUSF was created as an explicit cost recovery mechanism to replace implicit support previously received through rates.¹⁹ The Companies believe that, to the extent that explicit NUSF support is reduced, it is appropriate to offset that deficit through an increase in intrastate access rates. Without such an increase, sufficient support levels cannot be maintained for high cost areas of Nebraska.

The Companies support Qwest's assertion that "it is critical for carriers that lose support to be able to adjust their access rates to a revenue neutral rate."²⁰ However, the ability to petition for intrastate access rate increases should not be limited to carriers whose NUSF-26 distributions are less than their previous C-1628 distributions, as was suggested by Qwest.²¹ The Companies believe any carrier that experiences a reduction in NUSF support as calculated under the NUSF-26 mechanism should be permitted to implement an increase in intrastate access rates to offset that reduction.

Furthermore, the Companies strongly disagree with Qwest's unwarranted suggestion that distributions awarded to carriers through NUSF-7 should not be included in any calculation of revenue neutrality in establishing the level of access rate increases.²² NUSF-7 distributions that have been granted appear in the transitional mechanism

¹⁹ See *Companies' Comments* at pp. 2-3 and 12.

²⁰ See *Qwest Comments* at p. 8.

²¹ *Ibid.*

²² *Ibid.*

portion of the Commission's permanent NUSF support distribution model, and thus are included in the total amount of support distributed to each company. Given this, it is appropriate to treat NUSF-7 distributions as any other transitional mechanism distributions such as per-line backstop and OER, which are included in total NUSF support. In order to protect Nebraska consumers and not allow a carrier to reap a windfall, the Companies recommend that any NUSF-7 distributions a carrier receives should be included in a calculation of revenue neutrality when determining access rate increases.

Meanwhile, AT&T Communications of the Midwest, Inc. and TCG Omaha ("AT&T") assert in their comments that allowing any increase in intrastate access rates would not be "competitively neutral."²³ The Companies submit that the Commission already decided that replacement of reduced NUSF-26 support with intrastate access rates is appropriate. In Application No. C-3345, the Commission approved Qwest's intrastate access rate increase for the exact reasons illustrated above.²⁴ The Companies also note AT&T's lack of participation in Application No. C-3345 proceeding or the resulting negotiated stipulation, and thus AT&T's apparent concurrence. AT&T's objection to the potential rural ILEC intrastate access charge increases seems disingenuous given the fact that the materiality of Qwest's intrastate access charge increase is multiple times greater than a potential increase by other much smaller companies in the state.

²³ See *In the Matter of the Nebraska Public Service Commission, on its Own Motion, to Make Adjustments to the Universal Service Fund Mechanism Established in NUSF-26*, Application No NUSF-50, P.O. No. 1, Comments of AT&T ("AT&T Comments") (filed April 14, 2006) at pp. 5-6.

²⁴ See *In the Matter of the Nebraska Public Service Commission, on Its Own Motion, Seeking to Investigate Qwest's Switched Access Charge Rates*, Order Approving Settlement and Closing Docket, Application No. C-3345 (entered Nov. 8, 2005).

V. The Commission Should Maintain the Current \$17.50 Benchmark for Local Exchange Service.

The Companies reiterate the position outlined in their initial comments that the NUSF local exchange service benchmark should remain at \$17.50. First, the \$17.50 benchmark was developed through a deliberative and analytical process over several years.²⁵ Second, the Commission should recognize the pending intercarrier compensation changes at the FCC, the result of which may involve nationwide increases in rates since the majority of proposals before the FCC call for increases in the federal SLC caps.²⁶ Third, Nebraska's total minimum monthly local service charges for residential customers served by rural ILECs, including the federal SLC and all federal and state taxes and surcharges, are \$27.99 per month. This is already higher than the current residential national average monthly total local service charges of \$24.31 per month.²⁷ Nebraska rural residential customers who already pay more for their service than the national average have a lower per capita personal income as well.²⁸

Some commenters propose allowing an increase in the benchmark. Frontier, for example, supports a mandatory increase in the benchmark from \$17.50 to \$18.50 per month,²⁹ while Sprint Nextel Corporation, on behalf of United Telephone Company of the West and Sprint Communications Company L.P. ("Sprint") supports an increase of

²⁵ See *Companies' Comments* at p. 22.

²⁶ *Id.* at p. 23.

²⁷ *Ibid.*

²⁸ *Ibid.*

²⁹ See *Frontier Comments* at p. 4.

the benchmark at the option of the carrier.³⁰ Frontier's rationale for supporting such an increase is that "increasing the benchmark rate would raise the earnings of carriers receiving NUSF funding and thus reduce the NUSF funding requirement."³¹ The Companies believe that logic is flawed. Unless the Commission were to reduce the amount of support distributed through the per-line backstop and OER transitional mechanisms, raising the benchmark rate may merely shift the support among carriers instead of reducing the total amount of support distributed. Raising the benchmark may cause some carriers to receive less support because such carriers may exceed the ROR cap. In contrast, the support funds in excess of the ROR cap may be redistributed to carriers that still fall below the ROR cap, even after the benchmark increase.

For the above reasons, the Companies believe the Commission should refrain from any deviation from the existing, carefully considered local exchange service benchmark.

VI. The Commission Should Not Reduce The Amount Of Support Distributed To Individual Carriers By Applying A Proportional Reduction To Support Amounts Computed Using The Permanent NUSF Funding Mechanism.

Frontier suggests that the most appropriate manner in which to reduce the amount of support distributed to individual carriers is to apply an "across-the-board" reduction to existing support amounts, regardless of the basis for those amounts.³² The Companies

³⁰ See *In the Matter of the Nebraska Public Service Commission, on its Own Motion, to Make Adjustments to the Universal Service Fund Mechanism Established in NUSF-26*, Application No NUSF-50, P.O. No. 1, Comments of Sprint ("*Sprint Comments*") (filed March 24, 2006) at p. 2.

³¹ See *Frontier Comments* at p. 4.

³² See *Frontier Comments* at pp. 6-7. It appears that Frontier may be advocating that an "across-the-board" reduction should only take place after the transitional support mechanism has been eliminated. See *Frontier Comments* at pp. 2-3 and 6. As discussed above, the Companies agree with Frontier that modifications to the transitional mechanism are the first step that the Commission should take if it needs to reduce the amount of support distributed.

disagree with this recommendation. As discussed above, the Commission designed the permanent support mechanism so that it “highly targets support to the most costly and sparsely populated out-of-town service areas where NUSF support is needed.”³³ Simply making equally proportional reductions in support amounts which have been determined through two major modules, the SAM distribution module and the transitional mechanism module, greatly diminishes the targeting of NUSF support to the most costly service areas of the state that the Commission sought to accomplish through the NUSF-26 permanent funding mechanism. Doing this would contradict the Commission’s stated goals for establishing the permanent and transitional mechanisms.

When the Commission established the transitional mechanisms, it indicated that the purpose of these mechanisms was to “allow carriers an opportunity to make adjustments. . . .”³⁴ Therefore, the purpose of the transitional mechanisms was not to target support to the most costly areas of the state, but rather, to allow for a transition. As discussed above, in order to maintain the focused targeting of support to high-cost areas, if reductions are determined to be necessary, it is far more appropriate and better public policy to either eliminate the per-line backstop and OER transitional mechanisms or to gradually reduce the amount paid through such mechanisms. The Companies submit that if the elimination or reduction of the per-line backstop and OER transitional mechanisms does not provide a sufficient reduction in total support distributed to cope with NUSF

³³ See footnote 5.

³⁴ See *NUSF-26 Permanent Methodology Order* at ¶ 11.

funding constraints, then a more detailed examination of other alternatives to reduce the support distributed should be undertaken.³⁵

VII. Conclusion

As in their comments, the Companies continue to recommend that the Commission should not make changes to the permanent NUSF support mechanism, at least until the 5-year duration of the transitional mechanisms has expired.³⁶ However, if the Commission nonetheless implements changes to the permanent NUSF support mechanism to reduce the total amount of support distributed, the Companies recommend that the Commission either gradually reduce or eliminate the amount of support paid through the per-line backstop and OER transitional mechanisms. The Commission should not attempt to reduce the amount of NUSF support distributed by lowering the ROR cap, as this action may serve as a disincentive to investment and may reward inefficient carriers.

The Companies recommend that if the Commission implements changes that cause reductions to a carrier's NUSF support, the Commission should allow a carrier to raise its intrastate access rates in order to recover any revenues lost due to decreases in NUSF support. Finally, the Companies recommend that the local exchange service benchmark should not be raised from its current level of \$17.50 per month.

Dated: May 12, 2006.

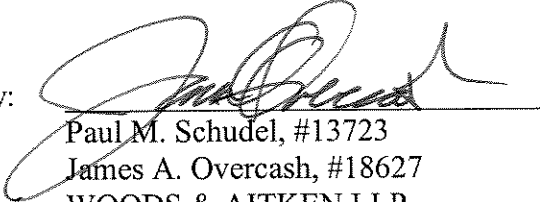
³⁵ See *Companies' Comments* at pp. 1-2.

³⁶ *Id.* at pp. 25-26.

Respectfully submitted,
"THE RURAL INDEPENDENT
COMPANIES":

Arlington Telephone Company
The Blair Telephone Company,
Cambridge Telephone Company,
Clarks Telecommunications Co.,
Consolidated Telco, Inc.,
Consolidated Telecom, Inc.
Consolidated Telephone Company,
Eastern Nebraska Telephone Company,
Great Plains Communications, Inc.,
Hartington Telecommunications Co., Inc.,
Hershey Cooperative Telephone Co.,
K&M Telephone Company, Inc.,
The Nebraska Central Telephone Company,
Northeast Nebraska Telephone Company,
Rock County Telephone Company,
Stanton Telecom Inc., and
Three River Telco

By:



Paul M. Schudel, #13723
James A. Overcash, #18627
WOODS & AITKEN LLP
301 South 13th Street, Suite 500
Lincoln, Nebraska 68508
(402) 437-8500
Their Attorneys

CERTIFICATE OF SERVICE

I hereby certify that on the 12th day of May, 2006, the original and five (5) paper copies, together with an electronic copy, of the foregoing **Reply Comments of The Rural Independent Companies** were served upon Andy S. Pollock, Executive Director of the Commission, by hand delivery.



James A. Overcash